

An Audit

# **Wisconsin Lottery**

*Department of Revenue*

## **2003-2004 Joint Legislative Audit Committee Members**

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May 8, 2003

Senator Carol A. Roessler and  
Representative Suzanne Jeskewitz, Co-chairpersons  
Joint Legislative Audit Committee  
State Capitol  
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

As required by s. 13.94(1)(em), Wis. Stats., we have completed a financial audit of the Wisconsin Lottery, which is administered by the Department of Revenue. We have issued an unqualified opinion on the Wisconsin Lottery's fiscal year (FY) 2001-02 and FY 2000-01 financial statements.

Total lottery sales increased from \$401.2 million in FY 2000-01 to \$427.6 million in FY 2001-02. The increase of \$26.4 million can primarily be attributed to ticket sales for on-line games, which, to a large extent, are related to the size of the jackpots. In August of 2001, the Wisconsin's Very Own Megabucks jackpot was unusually high at \$20.3 million, and the Powerball jackpot reached \$295.7 million—a record high jackpot at that time.

However, it should be noted that the Department of Revenue does not project this sales level to be maintained in the future. In October 2002, the Department projected FY 2002-03 lottery sales to be \$412.7 million. In addition, the Governor's 2003-05 Biennial Budget Proposal includes lottery sales estimates of \$417.2 million in FY 2003-04 and \$418.0 million in FY 2004-05. The Governor's budget also includes a proposal to privatize all lottery functions, except procurement and financial auditing services, starting in FY 2004-05.

We appreciate the courtesy and cooperation extended to us by the Department of Revenue. The Department's response follows our report.

Respectfully submitted,

A handwritten signature in cursive script that reads "Janice Mueller".

Janice Mueller  
State Auditor

JM/JG/ss



## Introduction ■

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***The Department of  
Revenue has  
administered the  
Wisconsin Lottery since  
August 1995.***

The Wisconsin Lottery began operations in September 1988, after Wisconsin voters adopted a constitutional amendment in 1987 allowing the Legislature to create a state lottery. Since August 1995, the Department of Revenue has managed the Wisconsin Lottery, which is permitted to sell tickets for instant and on-line games. Instant games are tickets that reveal a prize when consumers remove scratch-off or pull-tab coverings, while on-line games involve consumers picking numbers from an automated system, with winning numbers selected in drawings held at intervals ranging from daily to twice a week.

***The Wisconsin Lottery  
has generated  
approximately  
\$1.9 billion in property  
tax relief.***

Net lottery proceeds are required by the Wisconsin State Constitution to be distributed for property tax relief. From the Wisconsin Lottery's inception through fiscal year (FY) 2001-02, lottery sales have provided approximately \$1.9 billion in proceeds for property tax relief.

We completed financial audits of the Wisconsin Lottery to fulfill our audit responsibilities under s. 13.94(1)(em), Wis. Stats., and have issued an unqualified opinion on its financial statements for the years ended June 30, 2002 and 2001. As part of our audits, we reviewed lottery sales, expenses, and distributions for property tax relief through FY 2001-02.

## Ticket Sales

***The Wisconsin Lottery receives nearly all of its revenue from ticket sales.***

The Wisconsin Lottery derives its revenues from ticket sales almost exclusively. As shown in Table 1, instant and on-line ticket sales represented over 99 percent of the Wisconsin Lottery's operating revenues in FY 2000-01 and FY 2001-02.

Table 1

### Wisconsin Lottery Operating Revenues

|   | FY 2000-01           | Percentage of Total | FY 2001-02           | Percentage of Total |
|---|----------------------|---------------------|----------------------|---------------------|
| Instant Ticket Sales                    | \$237,944,206        | 58.9%               | \$238,214,016        | 55.7%               |
| On-line Ticket Sales                    | 163,244,349          | 40.5                | 189,336,327          | 44.2                |
| Retailer Fees and Miscellaneous Revenue | 2,537,387            | 0.6                 | 115,900              | 0.1                 |
| <b>Total</b>                            | <b>\$403,725,942</b> | <b>100.0%</b>       | <b>\$427,666,243</b> | <b>100.0%</b>       |

***Total lottery sales increased by \$26.4 million in FY 2001-02.***

Wisconsin Lottery ticket sales increased from \$401.2 million in FY 2000-01 to \$427.6 million in FY 2001-02, as shown in Table 2. This increase of \$26.4 million, which is the largest one-year increase since FY 1992-93, is primarily related to ticket sales for on-line games. While instant ticket sales have remained relatively stable, ticket sales for on-line games increased by \$26.2 million, from \$163.2 million in FY 2000-01 to \$189.4 million in FY 2001-02.



Table 2

**Wisconsin Lottery Sales**  
(in millions)

| Fiscal Year | Instant Games | On-line Games | Total Sales | Change in Dollars | Percentage Change |
|-------------|---------------|---------------|-------------|-------------------|-------------------|
| 1992-93     | \$310.9       | \$184.2       | \$495.1     | —                 | —                 |
| 1993-94     | 285.3         | 210.2         | 495.5       | \$0.4             | 0.1%              |
| 1994-95     | 320.3         | 198.6         | 518.9       | 23.4              | 4.7               |
| 1995-96     | 310.4         | 171.7         | 482.1       | (36.8)            | (7.1)             |
| 1996-97     | 273.4         | 157.7         | 431.1       | (51.0)            | (10.6)            |
| 1997-98     | 252.8         | 165.7         | 418.5       | (12.6)            | (2.9)             |
| 1998-99     | 230.8         | 197.5         | 428.3       | 9.8               | 2.3               |
| 1999-2000   | 241.1         | 165.6         | 406.7       | (21.6)            | (5.0)             |
| 2000-01     | 238.0         | 163.2         | 401.2       | (5.5)             | (1.4)             |
| 2001-02     | 238.2         | 189.4         | 427.6       | 26.4              | 6.6               |

***On-line game sales are closely related to the size of jackpots.***

Sales of on-line games are, to a great extent, related to the size of the available jackpots. As the amount of money in the jackpot increases, so do on-line ticket sales. The FY 2001-02 increase in on-line sales is likely the result of two large jackpots. In August 2001, the Powerball jackpot reached \$295.7 million and the Wisconsin Very Own Megabucks jackpot reached \$20.3 million, both of which were records at that time.

## Lottery Expenses

***Lottery operating expenses have increased 4.1 percent in the last five years.***

As shown in Table 3, Wisconsin Lottery operating expenses include prizes paid to winning ticket holders; commissions and incentives paid to ticket retailers; game production costs, such as instant ticket printing and delivery costs and on-line telecommunication charges; product information costs; and administrative and other costs, such as staff salaries. From FY 1997-98 to FY 2001-02, total operating expenses have increased from nearly \$293.7 million to \$305.8 million, an increase of 4.1 percent.

Table 3

## Lottery Operating Expenses

|                       | FY 1997-98           | FY 1998-99           | FY 1999-2000         | FY 2000-01           | FY 2001-02           |
|-----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Prizes                | \$238,402,180        | \$236,701,820        | \$233,222,783        | \$232,899,212        | \$242,056,463        |
| Retailer Compensation | 24,632,014           | 25,926,590           | 26,974,994           | 28,349,577           | 30,124,578           |
| Game Production*      | 17,751,419           | 17,990,698           | 18,919,754           | 18,587,218           | 19,605,356           |
| Product Information   | 4,347,039            | 4,541,450            | 4,488,334            | 4,607,042            | 4,520,065            |
| Others **             | 8,527,979            | 8,600,790            | 9,002,152            | 10,385,122           | 9,522,632            |
| <b>Total</b>          | <b>\$293,660,631</b> | <b>\$293,761,348</b> | <b>\$292,608,017</b> | <b>\$294,828,171</b> | <b>\$305,829,094</b> |

\* Includes instant ticket printing, instant ticket delivery, on-line vendor, and on-line telecommunication charges.

\*\* Includes staff salaries, fringe benefits, supplies, and depreciation expenses.

***Lottery prizes are required by state statute to be at least 50 percent of the annual lottery sales revenue.***

State statutes and legislative actions impose limitations on four types of lottery expenses. First, according to s. 25.75(3)(a), Wis. Stats., prizes must equal at least 50 percent of each year's revenues from the sale of lottery tickets. As shown in Table 4, since FY 1997-98, lottery prizes have ranged from 55.3 percent to 58.1 percent of total lottery sales.

Table 4

Prize Expense as a Percentage of Lottery Sales  
(in millions)

|              | Total Prize Expense | Total Lottery Sales | Percentage of Sales |
|--------------|---------------------|---------------------|---------------------|
| FY 1997-98   | \$238.4             | \$418.5             | 56.9%               |
| FY 1998-99   | 236.7               | 428.2               | 55.3                |
| FY 1999-2000 | 233.2               | 406.7               | 57.3                |
| FY 2000-01   | 232.9               | 401.2               | 58.1                |
| FY 2001-02   | 242.1               | 427.6               | 56.6                |

***State statutes establish retailers' basic commission rates and allow for an incentive-based performance program.***

Second, state statutes establish two methods by which retailers may be compensated for selling lottery tickets. Basic commission rates, which are the primary means of retailer compensation, are currently set by state statutes at 5.5 percent of the retail price for on-line tickets and 6.25 percent for instant tickets. Retailers may earn additional compensation through an incentive-based retailer performance program that began in January 2000. According to s. 565.02(4)(g), Wis. Stats., the performance program may provide up to an additional 1.0 percent of total sales as compensation to eligible retailers. Statutory language grants the Wisconsin Lottery substantial flexibility in structuring the retailer performance program, which currently has three components: a sales incentive, a winning ticket incentive, and short-term incentives for particular games or sets of games.

***Lottery expenses other than prize expense and retailer compensation are limited to 10 percent of gross revenues.***

Third, the Legislature has established a cap on lottery administrative expenses, which include all expenses except prize expense and retailer compensation. Some administrative expenses include a contract with GTECH Corporation to operate a computer system supporting the Wisconsin Lottery's games, informational advertising, and staff salaries. According to s. 25.75(3)(b), Wis. Stats., these administrative expenses are limited to no more than 10 percent of gross revenues. In the past five years, lottery administrative expenses have ranged from 7.3 percent of total operating revenues in FY 1997-98 and FY 1998-99 to 8.3 percent in FY 2000-01, as shown in Table 5.

Table 5

**Statutorily Defined Administrative Costs as a Percentage of Operating Revenue  
(in millions)**

|              | Total Statutorily Defined<br>Administrative Costs | Total Lottery Operating<br>Revenues | Percentage of<br>Operating Revenue |
|--------------|---|-------------------------------------|------------------------------------|
| FY 1997-98   | \$30.6  | \$418.9                             | 7.3%                               |
| FY 1998-99   | 31.1  | 428.4                               | 7.3                                |
| FY 1999-2000 | 32.4  | 406.8                               | 8.0                                |
| FY 2000-01   | 33.6  | 403.7                               | 8.3                                |
| FY 2001-02   | 33.6  | 427.7                               | 7.9                                |

Finally, the Wisconsin Constitution prohibits the expenditure of public funds, including revenues derived from lottery operations, for promotional advertising but permits informational advertising. Through legislative action, the Wisconsin Lottery's informational advertising expenses have been limited to \$4.6 million annually since FY 1990-91.

Because the Department of Revenue manages the Wisconsin Lottery in conjunction with various other functions and programs, such as its tax collection duties and the shared revenue program, the Lottery's administrative costs include some department-wide costs that are partially allocated to it. For example, the Wisconsin Lottery fully funds 94.5 full-time equivalent positions within the Division of Lottery; these positions are responsible for retailer relations, consumer relations, and lottery products research and development. Fifteen additional employees outside of the Division of Lottery perform some lottery functions, such as accounting and purchasing, and are partially funded by the Wisconsin Lottery. The salary and fringe benefit costs for these employees are to be allocated to various Department of Revenue programs based on which programs the employees' efforts benefit.

***Approximately \$90,000  
in lottery resources were  
used to process state tax  
returns in FY 2001-02.***

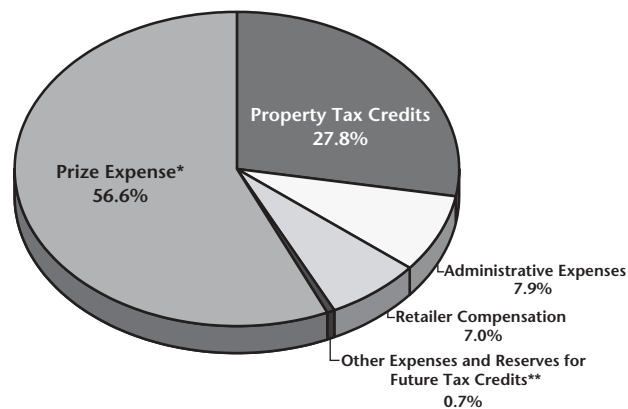
We found that most department-wide costs were properly allocated to the Wisconsin Lottery. However, we noted one questionable allocation related to salary and fringe benefit costs. During FY 2001-02, in an effort to reduce its overall operating costs, the Department of Revenue chose not to employ limited-term employees to process state income tax returns but, instead, had the majority of its permanent employees perform this function. Because the State Constitution requires that net proceeds from the Wisconsin Lottery be used only for property tax relief, the Legislative Audit Bureau raised concerns that lottery-funded employees, and therefore lottery resources, would be used for non-lottery purposes if lottery staff were assigned to the processing function. After these concerns were raised, the Department of Revenue decided not to have employees within the Division of Lottery process state tax returns. However, the 15 employees who are outside the Division of Lottery but funded in part by the Wisconsin Lottery did perform this function. We estimate that approximately \$90,000 in salaries and fringe benefit costs were funded by the Wisconsin Lottery to process state tax returns in FY 2001-02.

## Wisconsin Lottery Property Tax Credit

As noted, the Wisconsin Constitution requires that net proceeds from the Wisconsin Lottery be used only for property tax relief. Under current law, property tax relief is provided through a credit to owners of primary residences in Wisconsin and through a farmland tax relief credit. As shown in Figure 1, 27.8 percent of lottery revenues were distributed as property tax credits in FY 2001-02. This is the second-largest type of expense after lottery prizes.

Figure 1

### Distribution of Wisconsin Lottery Revenues FY 2001-02



\* Prize expense is based on total lottery sales.

\*\* Other expenses include transfers to state agencies for gaming law enforcement and property tax credit administration. Because estimates are used in distributing property tax credits, not all funds may be distributed each year. Remaining funds are carried over to the next year for distribution.

As shown in Table 6, the Wisconsin Lottery has provided \$823.9 million for property tax relief since FY 1997-98. Since its inception in 1988, the Wisconsin Lottery has provided a total \$1.9 billion for property tax relief.

Table 6

**Wisconsin Lottery Property Tax Relief**  
(in millions)

| Fiscal Year  | Amount Distributed | Average Property Tax Credit |
|--------------|--------------------|-----------------------------|
| 1997-98      | \$216.9            | \$ 77                       |
| 1998-99      | 153.9              | 52                          |
| 1999-2000    | 232.3              | 165                         |
| 2000-01      | 101.8              | 67                          |
| 2001-02      | 119.0              | 76                          |
| <b>Total</b> | <b>\$823.9</b>     |                             |

***Fluctuations in property tax relief distributions reflect judicial and legislative actions, as well as the amount generated by the Wisconsin Lottery.***

Both the amount distributed and the average property tax credit have fluctuated from year to year, because of variations in available lottery proceeds and because of judicial and legislative actions. For example:

- As a result of a delay in distributing FY 1996-97 credits, \$216.9 million from two years of lottery proceeds was distributed in FY 1997-98 to owners of all taxable properties.
- In FY 1999-2000, the Legislature provided a one-time general purpose revenue subsidy of \$76.0 million to the Wisconsin Lottery, thereby increasing the amount available for property tax credits by the same amount, to \$232.3 million.

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## Audit Opinion ■

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### *Independent Auditor's Report on the Financial Statements of the Wisconsin Lottery*

We have audited the accompanying financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2002 and 2001. These financial statements are the responsibility of Wisconsin Lottery management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to above present only the Wisconsin Lottery and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.


In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Wisconsin Lottery as of June 30, 2002 and 2001, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 16 to the financial statements, in fiscal year 2001-02 the Wisconsin Lottery implemented Governmental Accounting Standards Board Statement Number 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Lottery. The supplementary information included as Schedules 1, 2, and 3 is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. These schedules have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole. Management's discussion and analysis on pages 13 through 23 has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated May 2, 2003, on our consideration of the Wisconsin Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

May 2, 2003

LEGISLATIVE AUDIT BUREAU  
by   
Julie Gordon  
Audit Director



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# Management's Discussion and Analysis ■

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## *Prepared by Wisconsin Lottery Management*

This section of the Wisconsin Lottery's (the Lottery) annual financial report presents management's discussion and analysis of the financial performance of the Lottery during the fiscal year ended June 30, 2002. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of Wisconsin Lottery management.

### **Financial Highlights**

- Operating revenues for lottery activities increased by \$23.9 million, or 5.9 percent. Of this increase, ticket sales increased \$26.4 million, or 6.6 percent, while miscellaneous revenue decreased \$2.4 million, or 97.6 percent.
- Operating expenses for the year increased \$11.0 million, or 3.7 percent. While some expenses did not change significantly or decreased, prize expense increased \$9.2 million, or 4.0 percent; retailer commissions and incentives increased \$1.8 million, or 6.4 percent; and instant ticket printing costs increased \$0.7 million, or 25.3 percent.

- Non-operating revenue consisting of investment income decreased \$3.2 million, or 41.0 percent.
- Net income before transfers increased \$9.7 million, or 8.3 percent. The increase is a net result of the operating revenue increase, operating expense increase, and the non-operating revenue decrease.
- Net income transferred out for property tax relief increased \$17.2 million, or 16.9 percent, while transfers in from the General Fund decreased \$1.0 million, or 38.5 percent.

## **Overview of the Financial Statements**

The Lottery is accounted for as an enterprise activity/proprietary fund, reporting on all of the activity's assets and liabilities using the accrual basis of accounting much like a private business entity.

As such, this annual financial report consists of a series of financial statements, along with explanatory notes to the financial statements and supplementary schedules. The Statement of Net Assets is on page 25, the Statement of Revenues, Expenses, and Changes in Fund Net Assets is on page 26, and the Statement of Cash Flows is on page 27.

The Wisconsin Constitution requires net proceeds from the operations of the Lottery to be used to provide local property tax relief. In addition, balances from other gaming-related appropriations, including racing and charitable bingo operations, lapse to the Lottery Fund for distribution in the form of property tax relief. As a result, the net assets of the Lottery consist largely of capital assets (equipment), restricted income related to unrealized fair market value adjustments to investments, and restricted net assets for property tax relief. To assess the Lottery's financial position and financial health, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statement of Net Assets. The Statement of Revenues, Expenses, and Changes in Fund Net Assets and Statement of Cash Flows also provide information on income and expenses that should be reviewed as an indicator of the Lottery's financial performance.

## Net Assets

As shown in Table A, the Lottery's total net assets increased \$8.3 million, or 21.7 percent, from FY 2000-01 to FY 2001-02. The total liabilities decreased by \$16.5 million, or 10.2 percent, and the total assets decreased by \$8.2 million, or 4.1 percent. The total liabilities decreasing by more than the total assets decrease caused the increase in total net assets.

Table A

### Net Assets (in millions)

|  | FY 2001-02     | FY 2000-01     | Change        | Percentage Change |
|--|----------------|----------------|---------------|-------------------|
| Investments  | \$145.4        | \$152.9        | \$ (7.5)      | (4.9)%            |
| Capital assets (net of accumulated depreciation)       | 0.2            | 0.3            | (0.1)         | (33.3)            |
| Other assets   | 46.7           | 47.3           | (0.6)         | (1.3)             |
| <b>Total assets</b>                                    | <b>192.3</b>   | <b>200.5</b>   | <b>(8.2)</b>  | <b>(4.1)</b>      |
| Current liabilities                                    | \$ 30.8        | 37.3           | (6.5)         | (17.4)            |
| Long-term liabilities                                  | 115.0          | 125.0          | (10.0)        | (8.0)             |
| <b>Total liabilities</b>                               | <b>145.8</b>   | <b>162.3</b>   | <b>(16.5)</b> | <b>(10.2)</b>     |
| Net assets   |                |                |               |                   |
| Invested in capital assets                             | 0.2            | 0.3            | (0.1)         | (33.3)            |
| Restricted for investment fair market value adjustment | 15.8           | 13.1           | 2.7           | 20.6              |
| Restricted for property tax relief                     | 30.5           | 24.8           | 5.7           | 23.0              |
| <b>Total net assets</b>                                | <b>\$ 46.5</b> | <b>\$ 38.2</b> | <b>\$ 8.3</b> | <b>21.7</b>       |

The current liabilities decreased by \$6.5 million, or 17.4 percent, mainly due to a decrease of \$3.4 million in prizes payable and a decrease of \$2.9 million in due to other state programs. The long-term liabilities consist principally of the annuity prize liability for prizes paid in installments over several years. The long-term annuity prize liability decreased by \$10.0 million, or 8.0 percent. The total assets consist primarily of investments for prize annuities that decreased by \$7.5 million, or 4.9 percent.

The decreases in the annuity prize liability and the investments for prize annuities can be attributed to two factors. First, there was only one addition to the pool of installment prizes in FY 2001-02; all other persons who could have chosen to have their prizes paid in installments chose a single lump-sum payment instead. Second, 1999 Wisconsin Act 9 permitted the Lottery to offer a one-time cash buyout to qualified persons who were receiving their prize in installments. One past annuity prize winner's election, which was received by December 31, 2000, was processed in FY 2001-2002, which resulted in both the investment for prize annuities and the annuity prizes payables decreasing by \$3.8 million. For more details about the investments for prize annuities and annuity prizes payable, refer to Notes 4 and 5 in the notes to the financial statements.

Although the total net assets of the Lottery increased by \$8.3 million, these resources cannot be used for purposes other than restricted purposes. The net assets are invested in capital assets (equipment), restricted for an unrealized fair market value adjustment to investments, and restricted for property tax relief.

### **Change in Net Assets**

As shown in Table B, the change in net assets decreased by \$8.8 million, or 51.5 percent. The decrease can be attributed to an increase in total revenues of \$20.8 million, or 5.0 percent; an increase in total expenses of \$11.0 million, or 3.7 percent; and an increase in operating transfer out for property tax relief of \$17.2 million, or 16.9 percent.

Table B  
**Changes in Net Assets**  
(in millions)

|  | FY 2001-02    | FY 2000-01     | Change          | Percentage Change |
|--|---------------|----------------|-----------------|-------------------|
| <b>Revenues</b>                            |               |                |                 |                   |
| Operating revenues                         |               |                |                 |                   |
| Ticket sales                               | \$ 427.6      | \$ 401.2       | \$ 26.4         | 6.6%              |
| Retailer fees and miscellaneous revenue    | 0.1           | 2.5            | (2.4)           | (96.0)            |
| Non-operating revenues                     |               |                |                 |                   |
| Investment income                          | 4.6           | 7.8            | (3.2)           | (41.0)            |
| <b>Total Revenues</b>                      | <b>432.3</b>  | <b>411.5</b>   | <b>20.8</b>     | <b>5.0</b>        |
| <b>Expenses</b>                            |               |                |                 |                   |
| Program expenses                           |               |                |                 |                   |
| Prize Expense                              | 242.1         | 232.9          | 9.2             | 4.0%              |
| Retailer commissions and incentives        | 30.1          | 28.3           | 1.8             | 6.4               |
| Instant and on-line vendor services        | 12.3          | 12.1           | 0.2             | 1.7               |
| Other game related expenses                | 11.8          | 11.1           | 0.7             | 6.3               |
| Office administration expenses             | 9.5           | 10.4           | (0.9)           | (8.7)             |
| <b>Total Expenses</b>                      | <b>305.8</b>  | <b>294.8</b>   | <b>11.0</b>     | <b>3.7</b>        |
| <b>Net Income Before Transfers</b>         | <b>126.5</b>  | <b>116.7</b>   | <b>9.8</b>      | <b>8.4</b>        |
| <b>Operating Transfers</b>                 |               |                |                 |                   |
| Transfer for property tax relief           | (119.0)       | (101.8)        | (17.2)          | 16.9              |
| Transfer in from General Fund              | 1.6           | 2.6            | (1.0)           | (38.5)            |
| Transfer for compulsive gambling programs  | (0.3)         | –              | (0.3)           | –                 |
| Transfer for law enforcement               | (0.3)         | (0.2)          | (0.1)           | 50.0              |
| Transfer for lottery credit administration | (0.2)         | (0.2)          | –               | 0.0               |
| <b>Change in Net Assets</b>                | <b>\$ 8.3</b> | <b>\$ 17.1</b> | <b>\$ (8.8)</b> | <b>(51.5)</b>     |

The increase in total revenues of \$20.8 million is the result of ticket sales increasing \$26.4 million, or 6.6 percent. Ticket sales experienced a significant increase during FY 2001-02 because of high jackpots experienced by two of the Lottery's games, Powerball and Wisconsin's Very Own Megabucks. In August 2001, both games had

inordinately large jackpots. These jackpots generated significant sales for those products. All other products experienced little to no growth during the fiscal year. The increase in total expenses is the result of prize expense increasing \$9.2 million, or 4.0 percent, and retailer commissions and incentives increasing \$1.8 million, or 6.4 percent. In general, prize expense and retailer commissions and incentives are variable expenses, so they increase or decrease in relation to ticket sales. The increase in the operating transfer out for property tax relief also increased because it is a variable expense that increases or decreases in relation to ticket sales.

### Lottery Sales

Table C compares ticket sales, prize awards, and gross margin (sales minus prize awards) for each lottery game category for FY 2001-02 versus FY 2000-01.

Table C

#### Lottery Ticket Sales, Prize Awards, and Gross Margin (in millions)

|                       | FY 2001-02     |                |                | FY 2000-01     |                |                |
|-----------------------|----------------|----------------|----------------|----------------|----------------|----------------|
|                       | Ticket Sales   | Prize Awards   | Gross Margin   | Ticket Sales   | Prize Awards   | Gross Margin   |
| Instant               |                |                |                |                |                |                |
| Scratch               | \$233.6        | \$148.2        | \$ 85.4        | \$233.2        | \$146.8        | \$ 86.4        |
| Pull-tab              | 4.6            | 2.9            | 1.7            | 4.8            | 3.0            | 1.8            |
| On-line               |                |                |                |                |                |                |
| Supercash             | 29.5           | 15.0           | 14.5           | 29.2           | 16.9           | 12.3           |
| Powerball             | 86.6           | 40.9           | 45.7           | 67.1           | 31.6           | 35.5           |
| WI Very Own Megabucks | 31.2           | 16.2           | 15.0           | 22.9           | 12.0           | 10.9           |
| Daily Pick 3          | 25.5           | 11.7           | 13.8           | 26.1           | 12.8           | 13.3           |
| Daily Pick 4          | 9.6            | 4.3            | 5.3            | 9.3            | 4.6            | 4.7            |
| On-line-Terminated    |                |                |                |                |                |                |
| City Picks            | 2.3            | 1.2            | 1.1            | –              | –              | –              |
| Cash 4 Life           | –              | –              | –              | 0.9            | 0.3            | 0.6            |
| Money Roll            | 4.7            | 1.7            | 3.0            | 7.7            | 4.9            | 2.8            |
| <b>Total</b>          | <b>\$427.6</b> | <b>\$242.1</b> | <b>\$185.5</b> | <b>\$401.2</b> | <b>\$232.9</b> | <b>\$168.3</b> |

Sales increased in all product lines offered for the entire fiscal year except Daily Pick 3 and pull-tabs, while gross margin increased in all product lines offered for the entire year except scratch and pull-tab. Daily Pick 3's increase in gross margin was a result of a decreased prize payout for that product in FY 2001-02. The decrease in instant gross margin was due to the liability of the Lottery's television program, coupled with the Lottery's strategy of launching more tickets at higher price points (retail values greater than \$1), which have higher prize payouts.

Sales of instant tickets have remained relatively stable, partly as a result of the stagnant prize payout, unchanged since calendar year 1995. The Lottery continues to adjust instant product offerings by price point, so that there are more higher price point instant scratch tickets available for sale, and fewer \$1 instant tickets introduced. Beginning with the introduction of higher price point tickets in 1994, the Lottery's instant game strategy has mirrored industry strategy by offering more in prize payout as a player risks more in the purchase price of a ticket. Thus, higher price point tickets normally offer higher top prizes, better overall odds of winning, and higher prize payouts. Sales of \$1 instant scratch tickets have declined over the years, and sales of higher price point scratch tickets have increased.

Wisconsin's Very Own Megabucks is a "large jackpot lotto" that starts at \$1 million, and the jackpot continues to build until it is won. Wisconsin's Very Own Megabucks experienced a significant increase in sales when the jackpot rolled for over ten months to a new record of over \$20 million in August 2001. Sales at the initial jackpot levels did increase after the large jackpot run, as players were more aware of the in-state jackpot game.

Powerball is a multi-state lotto game that is played in several states. Sales increased in this product significantly due to a \$295 million jackpot during August 2001. This jackpot level compares against a highest jackpot of \$130 million during FY 2000-01. One drawing during these high jackpot periods can gross the Lottery from \$3 to \$7 million in sales.

## **Prize Expense**

In general, prize expense by game will increase or decrease from year to year in relation to the increase or decrease in sales for a particular game. However, except for the instant (scratch and pull-tab) game product category, prize expense is also impacted by the "luck of the draw." Prize expense for the instant game product category is more controllable, to a large degree, by printing a

predetermined number and value of winning tickets in the production of each instant game. Prize expense for all other lottery products is not predetermined. While each of these products is designed to yield a certain prize payout ratio of prizes to sales over a large number of drawings, actual prize payout is determined by lottery players' luck in matching the particular set of numbers randomly selected in each drawing for each game.

The total FY 2001-02 prize expense of \$242.1 million, which is shown as "prize awards" in Table C, reflects a 4 percent increase from FY 2000-01 prize expense. This is less than the 6.6 percent increase in ticket sales experienced in FY 2001-02. The following is a discussion of notable variances in prize expense.

Within product lines, prize expense of the instant games increased 1.0 percent, while sales from instant games remained virtually flat. This reflects a heavier concentration of products with higher price points. As previously noted, as a rule, games that retail at prices greater than \$1 pay out more in prizes than games that sell for a lower price.

Prize payout of Daily Pick 3, Daily Pick 4, and SuperCash! did not meet statistical expectations during FY 2001-02. Despite a 3.2 percent increase in Daily Pick 4 sales and a 1.0 percent increase in SuperCash! sales, prizes for these games decreased from FY 2000-01 by 6.5 percent and 11.2 percent, respectively. Daily Pick 3 sales decreased by 2.3 percent, while prize payout decreased by 8.6 percent. These figures reflect little or no change in payout or prize structure from one year to the next and instead reflect the relative luck of the players of each game.

Wisconsin's Very Own Megabucks and Powerball sales increases and payout increases are essentially the same. In FY 2001-02, Wisconsin's Very Own Megabucks experienced a 36.2 percent growth in sales and a 35.0 percent increase in prize payout compared to FY 2000-01. The prize expense for Wisconsin's Very Own Megabucks consists of the cost to fund the six-of-six jackpot and the cost to pay the actual prizes won for the three-, four-, and five-of-six categories, less any unclaimed prizes. Powerball experienced a 29.1 percent growth in sales and a 29.4 percent increase in prize payout. The prize expense for Powerball consists of 50 percent of each draw period's sales, plus or minus any increase or decrease in the prize reserve balances held by the Multi-State Lottery Association, less any unclaimed prizes.



## Other Expenses

As Table D shows, retailer commissions and incentives increased by \$1.8 million, or 6.4 percent. Instant and on-line vendor services increased by \$0.2 million, or 1.7 percent. Other game-related expenses increased by \$0.7 million, or 6.3 percent.

Table D

### Other Expenses (in millions)

|                                     | FY 2001-02 | FY 2000-01 | Change | Percentage Change |
|-------------------------------------|------------|------------|--------|-------------------|
| Retailer commissions and incentives | \$30.1     | \$28.3     | \$1.8  | 6.4%              |
| Instant and on-line vendor services | 12.3       | 12.1       | 0.2    | 1.7               |
| Other game related expenses         | 11.8       | 11.1       | 0.7    | 6.3               |
| Administrative expenses             | 9.5        | 10.4       | (0.9)  | (8.7)             |

The 6.4 percent increase in retailer commissions and incentives is a direct result of the 6.6 percent increase in Lottery ticket sales in FY 2001-02 compared to FY 2000-01. Lottery retailers are paid a commission based on gross sales. Due to the extraordinary increase in Powerball and Wisconsin's Very Own Megabucks sales in FY 2001-02, retailers received higher commissions versus the previous year, in which they sold fewer Powerball and Wisconsin's Very Own Megabucks tickets.

Expenses for instant and on-line vendor services increased 1.7 percent in FY 2001-02 as a result of a fee increase provided under the vendor services contract. The on-line gaming system portion of the contract provided for a 2.0 percent increase in the fixed-fee portion of the contract in FY 2001-02. Also paid are 0.2 percent of on-line net sales and 0.1 percent of instant net sales. The instant ticket system portion of the contract does not have an annual increase on the fixed fee but does provide for a payment of 0.1 percent of instant net sales.

Other game-related expenses consist of product information, instant ticket printing costs, on-line telecommunication charges, and instant ticket delivery. The 6.3 percent increase in other game-related

expenses is a combined result of increases in instant ticket printing costs and instant ticket delivery, while product information and on-line telecommunication costs declined from FY 2000-01 levels.

Instant ticket printing costs, which include instant scratch tickets and pull-tab tickets, increased by 25.3 percent in FY 2001-02, compared to FY 2000-01. This was the result of the strategy to increase distribution of higher price point scratch tickets, which are more expensive to print than \$1 tickets. Also, instant ticket delivery expenses increased by 13.1 percent in FY 2001-02 compared to FY 2000-01. This increase was caused by a new retail delivery service, implemented in FY 2001-02, that automatically ships new instant game releases to retailers. This new service increased the overall number of shipments to retailers, which led to the increased shipping costs.

These combined expense increases were mitigated by a slight decline in the product information expense, which fell by 1.9 percent in FY 2001-02. This modest decline resulted from product information production occurring in FY 2000-01 for a campaign that ran during both FY 2001-02 and FY 2000-01. Therefore, product information production costs were less in FY 2001-02 than in FY 2000-01.

Administrative expenses decreased by \$0.9 million, or 8.7 percent. These expenses were impacted by an increase in salaries and fringes of \$0.2 million, or 3.4 percent; a decrease in supplies and services of \$1.0 million, or 18.1 percent; and a decrease in depreciation expense of \$0.08 million, or 40.1 percent. The increase in salaries and fringes are a result of filling positions that were vacant during FY 2000-01. There was a large number of vacancies that year. There was also a decrease in the use of limited-term employees in FY 2001-02 due to the hiring of employees on a permanent basis. The decrease in supplies and services is mainly related to the relocation of the Lottery to the new Department of Revenue building in November 2001. In FY 2000-01 there were minor equipment expenses for the relocation in the amount of \$300,000. The rental costs decreased from FY 2000-01 in the amount of \$264,000 because the amount of space occupied decreased. In addition, a decrease of \$101,000 in royalty fees in FY 2001-02 occurred because of a reduced number of instant games with royalty payments.

### **Other Revenues**

The \$2.41 million, or 97.6 percent, decrease in miscellaneous revenue shown in Table E occurred primarily because the Multi-State Lottery Association returned \$1.7 million of the Cash 4 Life prize pool when the game ended, and the Lottery received \$0.75 million in liquidated damages in FY 2000-01. These receipts were non-recurring in FY 2001-02.

Table E

**Other Revenues**  
(in millions)

|   | FY 2001-02 | FY 2000-01 | Change   | Percentage Change |
|---|------------|------------|----------|-------------------|
| Miscellaneous revenue                   | \$0.06     | \$2.47     | \$(2.41) | (97.6)            |
| Investment income                       | 4.62       | 7.82       | (3.20)   | (40.9)            |
| Operating transfer in from General Fund | 1.59       | 2.60       | (1.01)   | (38.8)            |
| Retailer fees                           | 0.05       | 0.07       | (0.02)   | (28.6)            |

Investment income decreased by \$3.20 million, or 40.9 percent, because the fair market value of investments decreased \$2.0 million, the state investment pool earnings for the lottery fund decreased \$0.8 million, and the interest earned from the Powerball reserve account with the Multi-State Lottery Association decreased \$0.4 million. The operating transfer in from the General Fund decreased \$1.01 million, or 38.8 percent, because the balances from other gaming-related appropriations, including racing and charitable bingo operations, that lapse to the Lottery Fund for distribution in the form of property tax relief decreased by \$0.6 million. The remaining decrease of \$0.4 million occurred because the general purpose revenue appropriated in 1999 Wisconsin Act 9 to fund certain lottery expenses was effective only for FY 1999-2000 and FY 2000-01.

### **Contacting the Lottery's Financial Management**

This financial report is designed to provide the Legislature and the executive branch of government, the public, and other interested parties with an overview of the financial results of the Lottery's activities, and to show the Lottery's accountability for the money it receives. If you have questions about this report or need additional information, contact the Lottery Accounting Section at the Wisconsin Lottery, Post Office Box 8931, Madison, Wisconsin 53708-8931.

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Wisconsin Lottery  
Statement of Net Assets  
June 30, 2002 and 2001

Statement 1

|  | June 30, 2002  | Restated<br>June 30, 2001 |
|--|----------------|---------------------------|
| <b>Assets</b>  |                |                           |
| Current Assets:  |                |                           |
| Cash and cash equivalents  | \$ 31,317,951  | \$ 28,276,130             |
| Investments for prize annuities (Note 4)                         | 16,497,198     | 16,499,354                |
| Accounts receivable  | 2,535,318      | 3,043,485                 |
| Due from other state programs                                    | 2,238,765      | 3,816,670                 |
| Ticket inventory   | 849,622        | 1,413,367                 |
| Grand prize deposit (Note 7)                                     | 0              | 1,206,825                 |
| Prepaid expenses   | 406,964        | 609,483                   |
| Interest receivable  | 39,374         | 84,476                    |
| Total Current Assets   | 53,885,192     | 54,949,790                |
| Noncurrent Assets:   |                |                           |
| Investments for prize annuities (Note 4)                         | 128,877,434    | 136,400,027               |
| Grand prize deposit (Note 7)                                     | 9,305,276      | 8,844,193                 |
| Capital Assets: (Note 8)   |                |                           |
| Equipment  | 1,288,606      | 1,639,056                 |
| Leasehold improvements   | 168,077        | 168,077                   |
| Accumulated depreciation   | (1,219,626)    | (1,475,014)               |
| Total Noncurrent Assets  | 138,419,767    | 145,576,339               |
| Total Assets   | \$ 192,304,959 | \$ 200,526,129            |
| <b>Liabilities</b>   |                |                           |
| Current Liabilities:   |                |                           |
| Annuity prizes payable (Note 5)                                  | \$ 16,251,308  | \$ 16,415,682             |
| Prizes payable   | 7,616,802      | 11,010,135                |
| Accounts payable   | 2,667,825      | 2,353,997                 |
| Due to other state programs                                      | 2,948,874      | 5,853,677                 |
| Lottery association payable                                      | 440,923        | 939,349                   |
| Deferred revenue   | 368,055        | 287,329                   |
| Due to other governments   | 199,130        | 187,295                   |
| Accrued payroll  | 160,913        | 160,227                   |
| Compensated absences   | 120,878        | 112,429                   |
| Total Current Liabilities  | 30,774,708     | 37,320,120                |
| Long-Term Liabilities:   |                |                           |
| Annuity prizes payable (Note 5)                                  | 114,873,488    | 124,891,910               |
| Compensated absences   | 94,024         | 71,043                    |
| Total Long-term Liabilities                                      | 114,967,512    | 124,962,953               |
| Total Liabilities  | \$ 145,742,220 | \$ 162,283,073            |
| <b>Net Assets</b>  |                |                           |
| Net Assets:  |                |                           |
| Invested in capital assets, net of related debt                  | \$ 237,057     | \$ 332,119                |
| Restricted for investment fair market value adjustment (Note 10) | 15,800,334     | 13,129,667                |
| Restricted for property tax relief (Note 10)                     | 30,525,348     | 24,781,270                |
| Total Net Assets   | \$ 46,562,739  | \$ 38,243,056             |

The accompanying notes are an integral part of this statement.

Wisconsin Lottery  
**Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
**for the Years Ended June 30, 2002 and 2001**

|   | Year Ended<br>June 30, 2002 | Restated<br>Year Ended<br>June 30, 2001 |
|---|-----------------------------|---|
| <b>Operating Revenues</b>   |                             |   |
| Instant Ticket Sales  | \$ 238,214,016              | \$ 237,944,206                          |
| On-Line Ticket Sales  | 189,336,327                 | 163,244,349                             |
| Retailer Fees   | 52,364                      | 67,671                                  |
| Miscellaneous Revenue (Note 15)   | 63,536                      | 2,469,716                               |
| Total Operating Revenues  | <u>427,666,243</u>          | <u>403,725,942</u>                      |
| <b>Operating Expenses</b>   |                             |   |
| Program Expenses:   |                             |   |
| Instant Prize Expense   | 151,116,164                 | 149,827,633                             |
| On-Line Prize Expense   | 90,940,299                  | 83,071,579                              |
| Retailer Commissions and Incentives   | 30,124,578                  | 28,349,577                              |
| Instant and On-Line Vendor Services   | 12,344,833                  | 12,116,681                              |
| Product Information Costs   | 4,520,065                   | 4,607,042                               |
| Instant Ticket Printing Costs   | 3,625,080                   | 2,893,774                               |
| On-Line Telecommunication Charges   | 3,090,190                   | 3,094,601                               |
| Instant Ticket Delivery Costs   | 545,253                     | 482,162                                 |
| Total Program Expenses  | <u>296,306,462</u>          | <u>284,443,049</u>                      |
| Office Administration:  |                             |   |
| Salaries and Fringe Benefits  | 5,111,263                   | 4,944,999                               |
| Supplies and Services   | 4,296,796                   | 5,248,934                               |
| Depreciation Expense  | 114,573                     | 191,189                                 |
| Total Administrative Expenses   | <u>9,522,632</u>            | <u>10,385,122</u>                       |
| Total Operating Expenses  | <u>305,829,094</u>          | <u>294,828,171</u>                      |
| Net Operating Income  | 121,837,149                 | 108,897,771                             |
| <b>Non-Operating Revenues (Expenses) and Operating Transfers</b>                      |                             |   |
| Investment Income (Note 6)  | 4,618,585                   | 7,816,145                               |
| Gain (Loss) on Disposal of Fixed Assets   | (567)                       | (20,880)                                |
| Net Income Before Transfers   | 126,455,167                 | 116,693,036                             |
| Operating Transfers:  |                             |   |
| Transfers of Lottery proceeds for property tax relief (Note 11)                       | (118,993,392)               | (101,757,270)                           |
| Transfer In from General Fund   | 1,589,298                   | 2,602,581                               |
| Transfer to Department of Health and Family Services for compulsive gambling programs | (250,000)                   | 0                                       |
| Transfer to Department of Justice for law enforcement                                 | (287,400)                   | (247,000)                               |
| Transfer to Department of Revenue for lottery credit administration                   | (193,990)                   | (159,133)                               |
| Change in Net Assets  | <u>8,319,683</u>            | <u>17,132,214</u>                       |
| <b>Net Assets</b>   |                             |   |
| Total Net Assets, Beginning of Year   | 38,243,056                  | 21,110,842                              |
| Total Net Assets, End of Year   | <u>\$ 46,562,739</u>        | <u>\$ 38,243,056</u>                    |

The accompanying notes are an integral part of this statement.

Wisconsin Lottery  
**Statement of Cash Flows**  
for the Years Ended June 30, 2002 and 2001

Statement 3

|   | Year Ended<br>June 30, 2002 | Restated<br>Year Ended<br>June 30, 2001 |
|---|-----------------------------|---|
| <b>Cash Flows from Operating Activities</b>                     |                             |   |
| Cash Received from Retailers                                    | \$ 427,751,918              | \$ 402,958,948                          |
| Cash Paid for Prizes  | (265,860,693)               | (327,785,651)                           |
| Cash Paid/Received for Grand Prize Deposit                      | 1,206,825                   | 1,182,304                               |
| Cash Paid to Suppliers and Employees                            | (33,036,787)                | (36,216,534)                            |
| Cash Paid for Retailer Commissions and Incentives               | (29,524,829)                | (28,037,365)                            |
| Net Cash Provided by Operating Activities                       | <u>100,536,434</u>          | <u>12,101,702</u>                       |
| <b>Cash Flows from Non-Capital Financing Activities</b>         |                             |   |
| Transfer of Proceeds for Property Tax Credit                    | (120,703,205)               | (97,170,740)                            |
| Transfer of Proceeds from General Fund                          | 2,412,621                   | 12,129,099                              |
| Transfer of Proceeds for Law Enforcement                        | (286,765)                   | (247,000)                               |
| Transfer of Proceeds for Lottery Credit Administration          | (193,764)                   | (159,133)                               |
| Transfer of proceeds for Compulsive Gambling Programs           | (250,000)                   | 0                                       |
| Net Cash Used by Non-Capital Financing Activities               | <u>(119,021,113)</u>        | <u>(85,447,774)</u>                     |
| <b>Cash Flows from Capital and Related Financing Activities</b> |                             |   |
| Cash Paid for Purchase of Equipment                             | (20,078)                    | (77,418)                                |
| Cash Received from Sale of Equipment                            | 0                           | 10,120                                  |
| Net Cash Used by Capital and Related Financing Activities       | <u>(20,078)</u>             | <u>(67,298)</u>                         |
| <b>Cash Flows from Investing Activities</b>                     |                             |   |
| Interest Received   | 1,537,228                   | 2,143,521                               |
| Cash Received for Redemption of Bonds                           | 20,625,187                  | 93,143,535                              |
| Cash Paid for Purchase of Bonds                                 | (615,837)                   | 0                                       |
| Net Cash Provided by Investing Activities                       | <u>21,546,578</u>           | <u>95,287,056</u>                       |
| <b>Cash and Cash Equivalents</b>                                |                             |   |
| Net Increase (Decrease) in Cash and Cash Equivalents            | 3,041,821                   | 21,873,686                              |
| Cash and Cash Equivalents, Beginning of Year                    | <u>28,276,130</u>           | <u>6,402,444</u>                        |
| Cash and Cash Equivalents, End of Year                          | <u><u>\$ 31,317,951</u></u> | <u><u>\$ 28,276,130</u></u>             |

The accompanying notes are an integral part of this statement.

Wisconsin Lottery  
**Statement of Cash Flows**  
**for the Years Ended June 30, 2002 and 2001**

(Reconciliation of Net Operating Income to  
Net Cash Provided by Operations)

|   | Year Ended<br>June 30, 2002 | Restated<br>Year Ended<br>June 30, 2001 |
|---|-----------------------------|---|
| Net Operating Income  | \$ 121,837,149              | \$ 108,897,771                          |
| <b>Adjustments to Reconcile Net Operating Income<br/>to Net Cash Provided by Operating Activities</b> |                             |   |
| Depreciation Expense  | 114,573                     | 191,189                                 |
| <b>Changes In Assets and Liabilities</b>  |                             |   |
| Decrease (Increase) in Receivables  | 508,168                     | (286,590)                               |
| Decrease (Increase) in Grand Prize Deposit  | 1,206,825                   | 1,182,304                               |
| Decrease (Increase) in Ticket Inventory   | 563,745                     | (233,547)                               |
| Decrease (Increase) in Prepaid Expenses   | 202,518                     | 290,377                                 |
| Decrease (Increase) in Due from Other State Programs  | 114,282                     | (80,070)                                |
| Increase (Decrease) in Prizes Payable   | (23,395,355)                | (95,084,841)                            |
| Increase (Decrease) in Deferred Revenue   | 80,726                      | (314,158)                               |
| Increase (Decrease) in Due to Other State Programs  | (555,551)                   | (1,870,261)                             |
| Increase (Decrease) in Accounts Payable   | 313,829                     | (823,488)                               |
| Increase (Decrease) in Lottery Association Payable  | (498,426)                   | 138,397                                 |
| Increase (Decrease) in Due to Other Governments   | 11,835                      | 49,696                                  |
| Increase (Decrease) in Accrued Payroll  | 686                         | 19,498                                  |
| Increase (Decrease) in Compensated Absences   | 31,430                      | 25,425                                  |
| Total Adjustments   | (21,300,715)                | (96,796,069)                            |
| Net Cash Provided by Operating Activities   | <u>\$ 100,536,434</u>       | <u>\$ 12,101,702</u>                    |
| Non-Cash Activities   |                             |   |
| Net change in unrealized gains and losses   | \$ 2,665,376                | \$ 2,374,952                            |
| Vendor liquidated damages settlement (Note 15)  | 0                           | 250,000                                 |

The accompanying notes are an integral part of this statement.



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# Notes to the Financial Statements ■

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## 1. DESCRIPTION OF THE WISCONSIN LOTTERY

The Wisconsin Lottery was created in December 1987 and is administered by the Lottery Division within the Department of Revenue. The Wisconsin Lottery manages scratch-off and pull-tab instant ticket games and on-line ticket games. During FY 2001-02, the Wisconsin Lottery administered 119 active scratch-off, 11 active pull-tab, and 7 active on-line games.

The Wisconsin Lottery joined the Multi-State Lottery Association (MUSL) in June 1989. In FY 2001-02, the Wisconsin Lottery, as a member of MUSL, participated in one on-line MUSL game, Powerball (start date April 19, 1992).

During FY 2001-02, the Wisconsin Lottery also sold tickets for six other on-line games: Supercash! (start date February 4, 1991); Wisconsin's Very Own Megabucks (start date June 20, 1992); Daily Pick 3 (start date September 21, 1992); Daily Pick 4 (start date September 15, 1997); Money Roll (start date September 8, 2000, end date March 25, 2002); and City Picks (start date March 26, 2002; end date February 15, 2003).

The Wisconsin Lottery is accounted for within the Lottery Fund, which is part of the State of Wisconsin financial reporting entity. The reporting entity for the Wisconsin Lottery's stand-alone financial statements does not include the appropriations from which the property tax credit disbursements are made. However, disbursements to these appropriations are reported on the Statement of Revenues, Expenses, and Changes in Fund Net Assets as operating transfers out.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### A. Fund Accounting and Basis of Presentation

The financial statements of the Wisconsin Lottery have been prepared in conformance with generally accepted accounting principles (GAAP) for proprietary funds. The accompanying financial statements were prepared based upon the flow of economic resources focus and full accrual basis of accounting, with revenues recognized when earned and expenses recognized when incurred.

The Statement of Revenues, Expenses, and Changes in Fund Net Assets classifies the Wisconsin Lottery's fiscal year activity as either operating or non-operating. Because the Lottery Fund is an enterprise fund, which is a type of proprietary fund, it accounts for operations in a manner similar to private businesses in which operating revenues are derived from exchange transactions, such as sales. Operating expenses include the costs of sales, administration expenses, and depreciation on capital assets.

Certain revenues and expenses that are not related to the Wisconsin Lottery's primary purpose, such as investment income or the gain or loss on the disposal of capital assets, are reported as non-operating revenues and expenses.

The Wisconsin Lottery applies all Governmental Accounting Standards Board (GASB) pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

The State of Wisconsin monitors expenditures and records financial transactions using both the budgetary basis and the accrual basis of accounting. A reconciliation between the budgetary basis and the accrual basis of accounting for general operations expenditures is shown in Schedule 1.

### B. Revenue Recognition

Sales of instant scratch-off, instant pull-tab, and on-line tickets are made to the public through licensed retail sales agents.

Instant scratch-off ticket revenues are recognized when tickets are sold to the retailers. Retail sales agents have the right to return unsold instant scratch-off tickets for full refunds. See Note 2(I) for information about accounting for the retailers' right to return scratch-off tickets.

Revenues for pull-tab games are recognized upon sale of the tickets to the retail sales agents. No right of return exists for instant pull-tab tickets.

Ticket revenues for on-line games are recognized at the time the related drawings are held.

**C. Cash and Cash Equivalents**

All cash is deposited with the State of Wisconsin Treasurer and is required to be invested in the State Investment Fund. The State Investment Fund is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees. Since shares in the State Investment Fund are purchased in \$1,000 increments, Wisconsin Lottery cash balances below \$1,000 are deposited in the State's bank. The State Investment Fund is not registered with the Securities and Exchange Commission as an investment company.

**D. Retailer Commissions**

Retailer commissions, which are classified as program expenses, were 5.5 percent for on-line ticket sales and 6.25 percent for instant scratch and instant pull-tab tickets during FY 2001-02 and FY 2000-01. Nonprofit organizations receive additional commissions.

**E. Retailer Incentive Programs**

In addition to the retailer commissions discussed in Note 2(D), 1999 Wisconsin Act 9 established an incentive program for retailers who meet certain performance goals identified by the Wisconsin Lottery. This program began on January 1, 2000. Retailers must be in good standing and sell scratch-off tickets to participate in the program, which in FY 2001-02 had a winning ticket component, a short-term incentive component, and a sales incentive component. The total compensation provided to all retailers under the components of the program may not exceed 1 percent of the gross revenues from the sale of lottery tickets and lottery shares, which are multi-draw on-line tickets.

Under the winning ticket component, participating retailers that sell a winning scratch-off or on-line game ticket of \$600 or more receive a 2 percent commission of the prize award, up to a maximum of \$100,000 per winning ticket. Winning ticket payments are made weekly.

Up to four short-term incentives a year may be offered for pre-defined lengths of time. They focus on supporting one product or category of ticket products. Each incentive has a pre-determined goal which lottery retailers must achieve to receive additional compensation. Short-term incentives are limited to a total of \$400,000 per fiscal year, and no more than \$100,000 of funding can be expended on any one short-term incentive.

The sales incentive component allows participating retailers to earn additional commissions based on increased sales realized in any of three product categories: instant scratch-off tickets, on-line daily games (Supercash!, Daily Pick 3, Daily Pick 4, Money Roll, and City Picks), and on-line jackpot games (Wisconsin's Very Own Megabucks and Powerball). Subject to certain restrictions and allowances, retailers earn up to 10 percent of the increase in quarterly sales over sales for the same quarter of the previous year in each category. Payments for the instant scratch-off ticket and on-line daily portions of the sales incentive program are made quarterly. Due to the random nature of the on-line jackpot games and the overall program cap, sales incentive program payments for jackpot games are made annually.

**F. Administrative Expenses**

Administrative expenses are limited to 10 percent of gross lottery revenues. A summary of administrative expenses and related calculations of the administrative expense limit is included in Schedule 2.

**G. Prizes**

In accordance with Wisconsin Statutes, at least 50 percent of lottery sales must be returned in the form of prizes. Prizes may be claimed for a period of 180 days after the drawing for on-line games, or 180 days from the declaration of the end of a game for instant games. A summary of prize expenses is shown in Schedule 3.

**H. Ticket Inventory**

Ticket inventory consists of instant tickets for games in progress that have not yet been sold or shipped, and tickets for new games. The tickets are valued at cost using the first in–first out (FIFO) method. The cost of tickets sold is charged to operations. Unused tickets are charged to operations in the fiscal year the game ends.

**I. Deferred Revenue**

Until instant scratch-off tickets are sold to the public, retailers have the right to return unsold tickets to the Wisconsin Lottery for a refund. Therefore, receivables and cash collected in advance of sales of these tickets represent a liability of the Wisconsin Lottery. Deferred revenue is estimated and recorded based on historical information of unsold tickets returned by the retailers.

Depending on the on-line game, on-line tickets are sold for between three and eight subsequent drawings. On-line ticket revenues are recognized at the time the related drawings are held. All ticket sales for future drawings are recorded as deferred revenue.

**J. Capital Assets**

Fixed assets purchased for \$5,000 or more are recorded at historic cost and are depreciated using the straight-line method according to the following schedule:

|   | <u>Estimated Life</u> |
|---|-----------------------|
| Leasehold Improvements                          | 10 years              |
| Office Furniture and Security Equipment         | 10 years              |
| Printing and Microfilming Equipment             | 7 years               |
| Office, Computer, and Data Processing Equipment | 5 years               |
| Personal Computers—Acquired After July 1, 1998  | 4 years               |

**K. Employee Compensated Absences**

The Wisconsin Lottery's compensated absence liability consists of accumulated unpaid leave, compensatory time, personal holiday hours, and Saturday/legal holiday hours earned and vested as of June 30.

**L. Due to (from) Other State Programs**

During the course of operations, numerous transactions for goods provided or services rendered occur among individual state programs. The Statement of Net Assets classifies these receivables and payables as "Due from other state programs" or "Due to other state programs."

**M. Investment Valuation**

Pool shares of the State Investment Fund are bought and redeemed at \$1.00 based on the amortized cost of the investments in the Fund. Income calculations are based on the amortized cost of average pool balances. Where possible, investments in the State Investment Fund are reported at fair value for financial reporting purposes and are based on quoted market prices. Fair value determinations not based on quoted market prices include matrix pricing models or are calculated as the net present value of expected future cash flows. Nonparticipating contracts are valued at cost because these investments do not capture interest rate changes, while other investments are valued at par, which approximates fair value. Fair value of investments for prize annuities is based on quoted market prices.

**N. Disbursement of Lottery Proceeds**

The Wisconsin Lottery disburses Lottery proceeds through two means: the Lottery Tax Credit and the Farmland Tax Credit.

The Department of Administration, with the concurrence of the Legislature's Joint Finance Committee, determines the annual amount available for distribution as the Lottery Tax Credit in a given fiscal year. The Department of Revenue is notified of this amount by November 1. The Lottery Tax Credit is paid to municipalities on the 4<sup>th</sup> Monday in March of the same fiscal year.

The Farmland Tax Credit is determined by statute and is distributed to eligible individual and corporate taxpayers through the administration of the Wisconsin Department of Revenue's individual and corporate tax processes. The date of distribution of the Farmland Tax Credit is determined by the dates that eligible claims for it are processed. Therefore, disbursement of Farmland Tax Credit payments occurs throughout the year.

**3. DEPOSITS**

GASB Statement 3 requires deposits with financial institutions to be categorized to indicate the level of credit risk assumed. These risk categories are: 1) insured or collateralized, with securities held by the entity or by its agent in the entity's name; 2) collateralized, with securities held by the financial institution's trust department or agent in the entity's name; and 3) uninsured or uncollateralized. The Lottery had a balance of \$945 in the State's bank on June 30, 2002, and \$248 on June 30, 2001. Both balances met the criteria for risk category 1.

**4. INVESTMENTS**

The Wisconsin Lottery has investments that are held by MUSL, the Wisconsin Lottery, and the State Investment Fund.

Investments sufficient to finance the Cash 4 Life prize annuity payments for Wisconsin Lottery Cash 4 Life prize winners are held by MUSL; therefore, they are not shown as an asset, and the related annuity prizes payable are not shown as a liability on the Wisconsin Lottery financial statements. During FY 2000-01, MUSL sold the securities used to fund the Cash 4 Life lifetime prizes and replaced them with insurance annuities. The insurance company transfers weekly prize payments to the Wisconsin Lottery, which then distributes them to the prize winners.

Investments have been purchased by the Wisconsin Lottery to finance jackpot prizes that are payable as annuities over the 20-year or 25-year period. These investments for prize annuities are required by MUSL and the Wisconsin Lottery to be in the form of United States zero-coupon treasury securities, securities guaranteed by the United States government, or investment instruments issued by various brokerage firms secured by United States Treasury bonds held by custodial banks. See Note 5 for information related to the annuity prizes payable. The investments are scheduled to mature near the time prize payments become payable to winners. The State's custodial bank held investments for prize annuities with a fair value of \$145,374,633 as of June 30, 2002, and a fair value of \$152,899,381 as of June 30, 2001.

The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), and (bd), Wis. Stats., and include direct obligations of the United States and Canada, securities guaranteed by the United States government, securities of federally chartered corporations, unsecured notes of financial and industrial issuers, Yankee/Eurodollar issues, certificates of deposit issued by banks in the United States and solvent financial institutions in this state, and bankers' acceptances. The State of Wisconsin Investment Board's trustees may approve other prudent investments. The Board of Trustees has given standing authority to the State Investment Board to invest in resale agreements, financial futures contracts, options, and interest rate swaps.

GASB Statement 3 requires investments to be categorized to indicate the level of risk assumed by the Wisconsin Lottery. As of June 30, 2002, all of the assets in investments for prize annuities meet the criteria for risk category 1, because the investments are insured or registered, or are held by the State or its agent in the State's name. The Wisconsin Lottery's State Investment Fund shares are not categorized.

## 5. ANNUITY PRIZES PAYABLE

The Wisconsin Lottery has an unconditional obligation to pay all prize winners the future value of the prize. The reported value of future jackpot prize payment obligations is included in the financial statements as "Annuity prizes payable." To finance the annuity prize payments, the Wisconsin Lottery purchases, or has acquired from MUSL, investments scheduled to mature near the time prize payments become payable to the winners. Each year, an adjustment to the annuity prizes payable account is made to amortize the reported value using the effective interest method. The present value adjustment was \$9,819,227 for FY 2001-02, and \$12,586,071 for FY 2000-01. See Note 4 for information related to the investments for prize annuities. The reported values of future prize payment obligations were as follows:

| <u>Fiscal Year</u>                     | <u>FY 2001-02<br/>Total<br/>Payments</u> | <u>FY 2000-2001<br/>Total<br/>Payments</u> |
|--|--|--|
| 2001-02                                | —  | \$ 16,787,015                              |
| 2002-03                                | \$ 16,634,820                            | 16,909,086                                 |
| 2003-04                                | 16,749,915                               | 17,036,252                                 |
| 2004-05                                | 16,867,731                               | 17,166,588                                 |
| 2005-06                                | 16,991,521                               | 17,303,359                                 |
| 2006-07                                | 17,118,314                               | 17,443,614                                 |
| Subsequent Years                       | <u>119,068,061</u>                       | <u>124,118,897</u>                         |
| Future Prize Payments                  | 203,430,362                              | 226,764,811                                |
| Less: Present Value Adjustment         | <u>72,305,565</u>                        | <u>85,457,219</u>                          |
| Present Value of Future Prize Payments | <u>\$131,124,797</u>                     | <u>\$141,307,592</u>                       |

Annuity prizes payable activity for the fiscal years ended June 30, 2001 and June 30, 2002 was as follows:

|            | <u>Beginning<br/>Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending<br/>Balance</u> | <u>Due within<br/>One Year</u> |
|------------|------------------------------|------------------|------------------|---------------------------|--------------------------------|
| FY 2000-01 | \$227,319,989                | \$12,586,071     | \$(98,598,468)   | \$141,307,592             | \$16,415,682                   |
| FY 2001-02 | 141,307,592                  | 10,435,063       | (20,617,858)     | 131,124,797               | 16,251,308                     |

## 6. INVESTMENT INCOME (LOSS)

The investment income (loss) shown on the financial statements consists of several elements, as shown below:

|   | <u>FY 2001-02</u>  | <u>FY 2000-01</u>  |
|---|--------------------|--------------------|
| Interest from State Investment Fund               | \$1,477,576        | \$ 2,258,708       |
| Net Increase in Fair Value of Annuity Investments | 12,484,602         | 17,268,425         |
| Decrease for Amortization of Annuity Investments  | (9,819,227)        | (12,586,071)       |
| Net Change in Fair Value of State Investment Fund | 5,291              | (33,574)           |
| Interest from MUSL Prize Reserve Accounts         | 461,083            | 905,964            |
| Miscellaneous Interest                            | <u>9,260</u>       | <u>2,693</u>       |
| Total Investment Income (Loss)                    | <u>\$4,618,585</u> | <u>\$7,816,145</u> |



The Wisconsin Lottery earns interest on its shares invested in the State Investment Fund and on its share of the grand prize deposit fund established through MUSL, which is discussed in Note 7. Under GASB Statement 31, which requires investments to be reported at fair value, the net increases or decreases in fair value of investments for prize annuities and shares in the State Investment Fund are recognized as investment income (loss). Investments for prize annuities are amortized with a corresponding amortization adjustment to annuity prizes payable. The amortization of annuity prizes payable is included as a reduction to investment income.

## 7. GRAND PRIZE DEPOSIT

A grand prize deposit fund has been established by MUSL to indemnify states participating in the Powerball and Cash 4 Life games should a winning ticket not be properly paid. The combined Powerball and Cash 4 Life grand prize deposit for the State of Wisconsin was \$9,305,276 at June 30, 2002, and \$10,051,018 at June 30, 2001.

### A. Powerball

The total prize pool equals 50 percent of sales for each Powerball drawing. Of the total prize pool, 58.39 percent funds the grand prize pool, and 41.61 percent funds the low-tier prize pool. After the grand prize pool reaches the annuitized amount of \$5 million, then 2 percent of draw sales is distributed to the Prize Reserve Account (PRA) and Set Prize Reserve Account (SPRA) until they reach their caps of \$52 million and \$30 million, respectively. Interest earned on these accounts is deposited to the Unreserved Account. For some draws, the PRA and SPRA are reduced when the actual prizes won are greater than the amounts available in the prize pools. The Wisconsin Lottery has the right to a refund of the Wisconsin PRA and SPRA balances if it withdraws from MUSL. The Powerball grand prize deposit is made up of the following:

|                                     | <u>June 30, 2002</u> | <u>June 30, 2001</u> |
|-------------------------------------|----------------------|----------------------|
| Prize Reserve Account (PRA)         | \$5,514,054          | \$5,514,054          |
| Balance of Unreserved Account       | 1,843,494            | 1,382,411            |
| Set Prize Reserve Account (SPRA)    | <u>1,947,728</u>     | <u>1,947,728</u>     |
| Total Powerball Grand Prize Deposit | <u>\$9,305,276</u>   | <u>\$8,844,193</u>   |

Because the PRA and SPRA are refundable upon withdrawal from MUSL, it is the practice of the Wisconsin Lottery to report the prize reserve balances as a receivable (Grand Prize Deposit) and to reduce the prize expense by the same amount when the reserves are increased. The Wisconsin Lottery increases the Grand Prize Deposit and reports interest revenue in the period when the interest in the unreserved account is increased by MUSL.

**B. Cash 4 Life**

The Cash 4 Life game ended on September 7, 2000. During FY 2001-02, approximately one year after the end of the Cash 4 Life game, MUSL returned the Cash 4 Life prize reserve, \$1,206,825, to the Wisconsin Lottery. This amount was removed from the combined Powerball and Cash 4 Life Grand Prize Deposit.

**8. CAPITAL ASSETS**

Capital asset activity for the fiscal year ended June 30, 2002 was as follows:

|                                    | <u>Beginning Balance</u> | <u>Increases</u>  | <u>Decreases</u> | <u>Ending Balance</u> |
|------------------------------------|--------------------------|-------------------|------------------|-----------------------|
| Buildings and Improvements         | \$ 168,077               | \$ 0              | \$ 0             | \$ 168,077            |
| Machinery and Equipment            | <u>1,639,056</u>         | <u>20,078</u>     | <u>(370,528)</u> | <u>1,288,606</u>      |
| Total Capital Assets               | <u>1,807,133</u>         | <u>20,078</u>     | <u>(370,528)</u> | <u>1,456,683</u>      |
| Less Accumulated Depreciation for: |                          |                   |                  |                       |
| Buildings and Improvements         | 30,533                   | 12,344            | 0                | 42,877                |
| Machinery and Equipment            | <u>1,444,481</u>         | <u>102,228</u>    | <u>(369,960)</u> | <u>1,176,749</u>      |
| Total Accumulated Depreciation     | <u>1,475,014</u>         | <u>114,572</u>    | <u>(369,960)</u> | <u>1,219,626</u>      |
| Total Capital Assets, Net          | <u>\$ 332,119</u>        | <u>\$(94,494)</u> | <u>\$ (568)</u>  | <u>\$ 237,057</u>     |

Capital asset activity for the fiscal year ended June 30, 2001 was as follows:

|                                    | <u>Beginning Balance</u> | <u>Increases</u>  | <u>Decreases</u>   | <u>Ending Balance</u> |
|------------------------------------|--------------------------|-------------------|--------------------|-----------------------|
| Buildings and Improvements         | \$ 881,343               | \$119,348         | \$(832,614)        | \$ 168,077            |
| Machinery and Equipment            | <u>2,422,847</u>         | <u>67,650</u>     | <u>(851,441)</u>   | <u>1,639,056</u>      |
| Total Capital Assets               | <u>3,304,190</u>         | <u>186,998</u>    | <u>(1,684,055)</u> | <u>1,807,133</u>      |
| Less Accumulated Depreciation for: |                          |                   |                    |                       |
| Buildings and Improvements         | 841,095                  | 13,112            | (823,674)          | 30,533                |
| Machinery and Equipment            | <u>2,094,904</u>         | <u>178,077</u>    | <u>(828,500)</u>   | <u>1,444,481</u>      |
| Total Accumulated Depreciation     | <u>2,935,999</u>         | <u>191,189</u>    | <u>(1,652,174)</u> | <u>1,475,014</u>      |
| Total Capital Assets, Net          | <u>\$ 368,191</u>        | <u>\$ (4,191)</u> | <u>\$ (31,881)</u> | <u>\$ 332,119</u>     |

**9. OPERATING LEASES**

The Wisconsin Lottery occupied office, warehouse, and storage facilities in Milwaukee and on the Beltline Highway in Madison under operating leases during FY 2001-02. The lease for the Milwaukee facility expires June 30, 2004. The Madison Beltline facility lease expires March 31, 2006.

The following schedule summarizes the future minimum lease payments required under operating leases for both the Milwaukee and Madison facilities. Upon renewal at the beginning of FY 1999-2000, the Milwaukee warehouse lease payments are scheduled to increase annually based on a formula using the Consumer Price Index (CPI) each March. Since the future CPI is not known, the rate of actual increase between FY 2001-02 and FY 2002-03 lease payment amounts was used to estimate subsequent years' increases. The lease rate for the Madison Beltline Highway facility has been fixed for the remainder of the lease period.

|                                    | As of<br><u>June 30, 2002</u> | As of<br><u>June 30, 2001</u> |
|------------------------------------|-------------------------------|-------------------------------|
| Fiscal Year Ending June 30, 2002   | —                             | \$ 411,991                    |
| 2003                               | \$ 416,653                    | 422,948                       |
| 2004                               | 421,383                       | 434,218                       |
| 2005                               | 28,884                        | 28,884                        |
| 2006                               | <u>21,663</u>                 | <u>21,663</u>                 |
| Total Minimum<br>Payments Required | <u>\$888,583</u>              | <u>\$1,319,704</u>            |

Total lease expenses for the Wisconsin Lottery amounted to \$411,991 for the fiscal year ended June 30, 2002, and \$738,996 for the fiscal year ended June 30, 2001.

## 10. RESTRICTED NET ASSETS

The Wisconsin Lottery has restricted net assets for fair value adjustments of investments of \$15,800,334 as of June 30, 2002, and \$13,129,667 as of June 30, 2001. The Wisconsin Lottery does not realize gains or losses from the change in fair value of its annuity investments because it holds the investments until maturity to pay the annual prize payments. Therefore, fair value adjustments recognized as investment income as a result of applying GASB Statement 31 are not available for distribution as property tax credits.

The portion of restricted net assets related to capital assets is reported in detail in Note 8.

The Wisconsin Constitution requires net proceeds from the operations of the Wisconsin Lottery to be used to provide local property tax relief. In addition, balances from other gaming-related appropriations, including racing and charitable bingo operations, lapse to the Lottery Fund for distribution in the form of property tax relief. This balance makes up the remainder of the restricted net assets.

## 11. DISTRIBUTION OF NET PROCEEDS

For FY 2001-02, a total of \$118,993,392 in Wisconsin Lottery proceeds and other gaming-related proceeds was used for the following purposes: \$105,248,760 for Lottery Tax Credits, and \$13,744,632 for Farmland Tax Credits. For FY 2000-01, a total of \$101,757,270 in net proceeds was used for the following purposes: \$90,009,299 for Lottery Tax Credits, and \$11,747,971 for Farmland Tax Credits.

## 12. EMPLOYEE RETIREMENT PLAN

Permanent, full-time employees of the Wisconsin Lottery are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by Chapter 40 of Wisconsin Statutes. State and local government public employees are entitled to an annual formula retirement benefit based on: 1) the employee's final average earnings, 2) years of creditable service, and 3) a formula factor. If an employee's contributions, matching employer's contributions, and interest credited to the employee's account exceed the value of the formula benefit, the retirement benefit may instead be calculated as a money purchase benefit. The Wisconsin Retirement System is considered part of the State of Wisconsin's financial reporting entity. Copies of the separately issued financial report that includes financial statements and required supplementary information may be obtained by writing to:

Department of Employee Trust Funds  
P.O. Box 7931  
Madison, WI 53707-7931

The report is also available on the Department of Employee Trust Funds' Web site, <http://badger.state.wi.us/agencies/etf/>.

Generally, the State's policy is to fund retirement contributions on a level-percentage-of-payroll basis to meet normal and prior service costs of the retirement system. Prior service costs are amortized over 40 years, beginning January 2, 1990. The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee's classification, plus employer contributions at a rate determined annually. The Wisconsin Lottery's contributions to the plan were \$478,385 for FY 2001-02 and \$514,427 for FY 2000-01. The relative position of the Wisconsin Lottery in the Wisconsin Retirement System is not available because the Wisconsin Retirement System is a statewide, multi-employer plan.

**13. COMPENSATED ABSENCES**

Compensated absence activity for the fiscal year ended June 30, 2002 was as follows:

|                      | <u>Beginning<br/>Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending<br/>Balance</u> | <u>Due within<br/>One Year</u> |
|----------------------|------------------------------|------------------|------------------|---------------------------|--------------------------------|
| Compensated Absences | \$183,471                    | \$143,859        | \$(112,429)      | \$214,901                 | \$120,878                      |

**14. EFFECT OF WISCONSIN LAW CHANGES ON LOTTERY PRIZE PAYMENTS**

Before the passage of 1999 Wisconsin Act 9, players of Wisconsin's Very Own Megabucks and Powerball selected the lump-sum or annuity payment option at the time a ticket was purchased. Upon enactment of 1999 Wisconsin Act 9, on October 27, 1999, pre-selection of the payment option at the time a ticket is purchased was no longer necessary. Subject to certain restrictions, Wisconsin Lottery prize winners are currently allowed a 60-day period after becoming entitled to a lottery prize to elect either the lump-sum or the annuity payment option.

1999 Wisconsin Act 9 further provided that lottery prize winners who became entitled to receive payment of a lottery prize on or before October 21, 1998, and who currently received payment of the lottery prize in the form of an annuity, had the option to elect to change the form of payment to a lump sum if the lottery prize was payable over at least ten years. Persons making this election needed do so between July 1, 1999, and December 31, 2000.

Twelve past annuity prize winners elected to receive the balance of their prize payments as lump-sum payments during FY 2000-01. One additional past annuity prize winner's election, which was received by December 31, 2000, was processed in FY 2001-02. As a result, the balances of both the investment for prize annuities and the annuity prizes payable accounts decreased by \$3,823,484 in FY 2001-02 and by \$75,658,021 in FY 2000-01. The Wisconsin Lottery did not experience gains or losses on these transactions, since each winner received current market value at the time of the conversion.

**15. NON-RECURRING MISCELLANEOUS REVENUE****A. Cash 4 Life Prize Pool Reversion**

During FY 2000-01, MUSL returned the Wisconsin Lottery's share of the remaining Cash 4 Life prize pool. The amount in this pool had been recorded as prize expense in the fiscal years that the game was active. As a result, the Wisconsin Lottery's reversion share of \$1,673,733 was treated as a refund of prior years' expense and reported as miscellaneous revenue.

**B. Liquidated Damages**

Under a previously negotiated settlement, GTECH Corporation, the Wisconsin Lottery's computer system support supplier, paid damages to the Wisconsin Lottery in FY 2000-01. According to the terms of the agreement, GTECH paid \$500,000 in cash and \$250,000 in supplies. The total of these two payments, \$750,000, was reported as miscellaneous revenue.

**16. CHANGE IN ACCOUNTING PRINCIPLE**

The Wisconsin Lottery implemented a new financial reporting model for FY 2001-02, as required by the provisions of GASB Statement Number 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. Financial statement presentation changed to reflect net assets invested in capital assets, net of related debt; net assets restricted for investment fair market value adjustment; and net assets restricted for property tax relief. In addition, management added a discussion and analysis for operations. The FY 2000-01 information was also restated to conform with the new financial reporting model; however, GASB Statement Number 34 had no effect on total net assets or the change in net assets.

**17. RESTATEMENT OF FY 2000-01 FINANCIAL STATEMENTS**

An adjustment was made to properly account for the liability associated with cancelled drafts in prior years. In the FY 2000-01 financial statements, accounts payable and miscellaneous revenue were reduced by \$28,832. In addition, certain amounts presented in the prior year statements have been reclassified in order to be consistent with the current year's presentation under GASB Statement Number 34.

**18. SUBSEQUENT EVENT**

On February 18, 2003, Governor James Doyle presented his proposed state budget for the biennium ending June 30, 2005. The Governor's budget proposal recommends privatizing lottery operations beginning in FY 2004-05. If it is approved, the Secretary of the Department of Revenue would be given authority to contract in whole or in part for lottery services. If the lottery is entirely privatized, 94.5 full-time positions of the Lottery Division would be eliminated. The Department of Revenue would retain positions essential for contract negotiation, compliance, and auditing. Privatization would proceed only if privatization proposals cost less than state provision of lottery services.

## Schedule 1

**Reconciliation of Lottery General Operations Expenses to the  
Budgetary Basis of Accounting  
FY 2001-02**

|                                     |
|-------------------------------------|
| <b>Salaries and Fringe Benefits</b> |
|-------------------------------------|

|  |              |
|--|--------------|
| Per Financial Statement                            | \$ 5,111,263 |
| Adjustments to Financial Statement Balance:        |              |
| Cash paid in FY 2001-02 but expensed in FY 2000-01 | 183,587      |
| Cash paid in FY 2002-03 but expensed in FY 2001-02 | (215,016)    |
|  | \$ 5,079,834 |
| Budgetary Basis                                    | \$ 5,079,834 |

|                              |
|------------------------------|
| <b>Supplies and Services</b> |
|------------------------------|

|   |               |
|---|---------------|
| Per Financial Statement:                              |               |
| On-line telecommunication charges                     | \$ 3,090,190  |
| Product information                                   | 4,520,065     |
| Instant ticket printing costs                         | 3,625,080     |
| Supplies and services                                 | 4,296,796     |
| Instant ticket delivery costs                         | 545,253       |
| Depreciation expense                                  | 114,573       |
|   | 16,191,957    |
| Total per Financial Statement                         | 16,191,957    |
| Adjustments to Financial Statement Balance:           |               |
| Depreciation expense                                  | (114,573)     |
| Cash paid in FY 2000-01 but expensed in FY 2001-02    | (1,413,367)   |
| Cash paid in FY 2001-02 but expensed in FY 2000-01    | 38,005        |
| Cash paid in FY 2001-02 but expensed in FY 2002-03    | 849,622       |
| Cash paid in FY 2002-03 but expensed in FY 2001-02    | (63,408)      |
| Cash received in FY2001-02 but recorded incorrectly   | (5,940)       |
| Supplies purchased with the Vendor Fees Appropriation | (143,511)     |
|   | \$ 15,338,785 |
| Budgetary Basis                                       | \$ 15,338,785 |

|                       |
|-----------------------|
| <b>Capital Assets</b> |
|-----------------------|

|   |           |
|---|-----------|
| Per Financial Statement                     | \$ 0      |
| Adjustments to Financial Statement Balance: |           |
| FY 2001-02 permanent property capitalized   | (350,450) |
| FY 2001-02 disposal of permanent property   | 370,528   |
|   | \$ 20,078 |
| Budgetary Basis                             | \$ 20,078 |

The accompanying notes are an integral part of this statement.

## Schedule 2

**Statutorily Defined  
Lottery Administrative Expenses**

|  | Fiscal Year<br>Ended<br>June 30, 2002 | Fiscal Year<br>Ended<br>June 30, 2001 | Fiscal Year<br>Ended<br>June 30, 2000 |
|--|---------------------------------------|---------------------------------------|---------------------------------------|
| <b>Administrative Expenses</b>   |                                       |                                       |                                       |
| Instant and On-line Vendor Services  | \$ 12,344,833                         | \$ 12,116,681                         | \$ 11,790,160                         |
| Salaries and Fringe Benefits   | 5,111,263                             | 4,944,999                             | 4,565,186                             |
| On-line Telecommunication Charges  | 3,090,190                             | 3,094,601                             | 3,603,065                             |
| Supplies and Services  | 4,296,796                             | 5,248,934                             | 3,797,127                             |
| Product Information  | 4,520,065                             | 4,607,042                             | 4,488,334                             |
| Instant Ticket Printing Costs  | 3,625,080                             | 2,893,774                             | 3,526,528                             |
| Instant Ticket Delivery Costs  | 545,253                               | 482,162                               | 414,429                               |
| Depreciation Expense   | 114,573                               | 191,189                               | 225,410                               |
| Total Administrative Expenses as Determined in<br>Accordance with s. 25.75 (3)(b), Wis. Stats. | <u>\$ 33,648,053</u>                  | <u>\$ 33,579,382</u>                  | <u>\$ 32,410,239</u>                  |
| Gross Lottery Operating Revenues   | <u>\$ 427,666,243</u>                 | <u>\$ 403,725,942</u>                 | <u>\$ 406,784,089</u>                 |
| Administrative Expenses as a<br>Percentage of Lottery Revenues                                 | 7.87%                                 | 8.32%                                 | 7.97%                                 |

Section 25.75(3)(b), Wis. Stats., limits the Lottery's administrative expenses to 10 percent of gross lottery revenues. Gross lottery revenues include lottery ticket sales and retailer fees. Retailer commissions are not included as an administrative expense in the calculation.

The accompanying notes are an integral part of this statement.



Schedule 3

Summary of Prize Expenses

Section 25.75(3)(a), Wis. Stats., requires that at least 50 percent of each year's revenues from the sale of lottery tickets be returned as prizes to the holders of winning lottery tickets. The amounts expended for winning lottery tickets for the past five years, for both instant and on-line games, are summarized below.

| <b>Fiscal Year 2001-02</b> |                          |                         |   |
|----------------------------|--------------------------|-------------------------|---|
|                            | <u>Prize<br/>Expense</u> | <u>Ticket<br/>Sales</u> | <u>Prize Expense as<br/>a Percentage of Sales</u> |
| Instant Games              | \$151,116,164            | \$238,214,016           | 63.4%   |
| On-Line Games              | <u>90,940,299</u>        | <u>189,336,327</u>      | 48.0  |
| Total for Fiscal Year      | \$242,056,463            | \$427,550,343           | 56.6  |

| <b>Fiscal Year 2000-01</b> |                          |                         |   |
|----------------------------|--------------------------|-------------------------|---|
|                            | <u>Prize<br/>Expense</u> | <u>Ticket<br/>Sales</u> | <u>Prize Expense as<br/>a Percentage of Sales</u> |
| Instant Games              | \$149,827,633            | \$237,944,206           | 63.0%   |
| On-Line Games              | <u>83,071,579</u>        | <u>163,244,349</u>      | 50.9  |
| Total for Fiscal Year      | \$232,899,212            | \$401,188,555           | 58.1  |

| <b>Fiscal Year 1999-2000</b> |                          |                         |   |
|------------------------------|--------------------------|-------------------------|---|
|                              | <u>Prize<br/>Expense</u> | <u>Ticket<br/>Sales</u> | <u>Prize Expense as<br/>a Percentage of Sales</u> |
| Instant Games                | \$152,238,914            | \$241,040,895           | 63.2%   |
| On-Line Games                | <u>80,983,868</u>        | <u>165,629,273</u>      | 48.9  |
| Total for Fiscal Year        | \$233,222,782            | \$406,670,168           | 57.3  |

| <b>Fiscal Year 1998-99</b> |                          |                         |   |
|----------------------------|--------------------------|-------------------------|---|
|                            | <u>Prize<br/>Expense</u> | <u>Ticket<br/>Sales</u> | <u>Prize Expense as<br/>a Percentage of Sales</u> |
| Instant Games              | \$143,841,064            | \$230,817,635           | 62.3%   |
| On-Line Games              | <u>92,860,756</u>        | <u>197,378,447</u>      | 47.0  |
| Total for Fiscal Year      | \$236,701,820            | \$428,196,082           | 55.3  |

| <b>Fiscal Year 1997-98</b> |                          |                         |   |
|----------------------------|--------------------------|-------------------------|---|
|                            | <u>Prize<br/>Expense</u> | <u>Ticket<br/>Sales</u> | <u>Prize Expense as<br/>a Percentage of Sales</u> |
| Instant Games              | \$157,853,848            | \$252,915,444           | 62.4%   |
| On-Line Games              | <u>80,548,332</u>        | <u>165,724,843</u>      | 48.6  |
| Total for Fiscal Year      | \$238,402,180            | \$418,640,287           | 56.9  |

NOTE: The above amounts are based on an accrual basis of accounting, with adjustments made to prize expenses for unclaimed winning tickets and reserve accounts. For each game, the prize structure represents the number, value, and odds of winning for each prize and is used to estimate the expected amounts to be paid to lottery winners. The games' actual prizes (prize expense) may be less than the games' structure because of unclaimed winning tickets and deposits in reserve accounts.

The accompanying notes are an integral part of this statement.



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## Report on Compliance and Control ■

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### ***Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards***

We have audited the financial statements of the Wisconsin Lottery as of and for the years ended June 30, 2002 and 2001, and have issued our report thereon dated May 2, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

#### **COMPLIANCE**

As part of obtaining reasonable assurance about whether the Wisconsin Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered the Wisconsin Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This independent auditor's report is intended for the information and use of the Wisconsin Lottery staff, the Department of Revenue's management, and the Wisconsin Legislature. This independent auditor's report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on compliance or provide assurance on internal control over financial reporting, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

May 2, 2003

by   
Julie Gordon  
Audit Director



# State of Wisconsin • DEPARTMENT OF REVENUE

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*Jim Doyle*  
Governor

*Michael L. Morgan*  
Secretary of Revenue

May 5, 2003

Ms. Janice Mueller, State Auditor  
Legislative Audit Bureau  
22 East Mifflin Street, Suite 500  
Madison, WI 53703

Dear Ms. Mueller:

We appreciate the opportunity to comment on the Legislative Audit Bureau's annual financial review of the Wisconsin Lottery. The Department of Revenue (DOR) wishes to thank you and your staff for your detailed, independent analysis.

As the audit report notes, the Wisconsin Lottery achieved solid gains in sales, retailer commissions and property tax relief in fiscal year 2001-02:

- Ticket sales of \$427.5 million, up 6.8%
- Prizes of \$242.1 million, up 1.5%
- Retailer compensation of \$30.1 million, up 22.3%
- Property tax relief of \$119.0 million, up 16.9%

We value the Legislative Audit Bureau's continued feedback and guidance regarding the operations of the Wisconsin Lottery. Thank you for your thorough review and we look forward to your future assistance.

Sincerely,

Michael L. Morgan  
Secretary of Revenue